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IN THE

Supreme Court of the United States

October Term, 1964

No. 593

A. H. KARPE,

Petitioner,

vs.

THE UNITED STATES and BIRDA M. VIERA,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Claims.

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A. H. KARPE,

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THE UNITED STATES and BIRDA M. VIERA,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Claims.

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Claims entered in the above case on July 17, 1964.

Opinion Below.

The opinion of the United States Court of Claims is reported at ..... F. 2d ....., ... Ct. Cl. ..... (not officially reported as yet), 14 AFTR 2d 5176.

Jurisdiction.

The judgment of the Court of Claims was made and entered July 17, 1964, and a copy thereof is appended to this petition in the Appendix at pp. 1 to 32. The jurisdiction of this Court is invoked under 28 U. S. C. 1255(1).

Questions Presented.

This case involves the application and interpretation of Sections 1311 to 1314 of the Internal Revenue Code, 26 U. S. C. 1311-1314. These sections (commonly and herein referred to as the "mitigation sections"), in general, provide for certain specified adjustments of income or deductions, under specified circumstances, for years which are otherwise barred by the primary statute of limitations, 26 U. S. C. 6501(a).

Petitioner, in a prior case, *A. H. Karpe v. Riddell,* 56-2 USTC par. 10,016, 51 AFTR 775 (not officially reported), obtained a judgment for the refund of income taxes overpaid. As a result of that judgment, petitioner's wife's income had been understated in her separate return. On the date that judgment became final the assessment of a deficiency against petitioner's wife was barred by the provisions of said section 6501-(a). Nevertheless, a statutory notice of deficiency was issued against her under Section 1314 of the Internal Revenue Code. A portion of the refund due Petitioner was withheld by the Internal Revenue Service and credited against the deficiency assessed against the wife. It was for that amount that this action was brought by Petitioner. The respondent (defendant below) did not plead the mitigation sections. The Court of Claims held said sections were, nevertheless, in issue by reason of the statutory notice of deficiency having been stipulated into evidence. On the merits, the Court decided in favor of defendant on the ground that the mitigation sections are to be given a liberal construction. The questions presented are:

1. Whether the mitigation sections are to be construed strictly since they are in derogation of the

primary statute of limitations or are they to be given a liberal interpretation as a relief provision.

2. Whether the mitigation sections must be pleaded to put them in issue.

3. Whether, if the mitigation sections must be pleaded, such requirement is waived upon the introduction into evidence of the statutory notice of deficiency which contains a statement that the deficiency is proposed under the mitigation sections.

Statutes Involved.

The pertinent portions of Sections 1311-1315 and 6501(a) of the Internal Revenue Code, 26 U. S. C. 1311-1314; 6501(a), are set forth in the Appendix at pp. 33 to 44.

Statement.

This action arose on a petition filed by Petitioner on a Notice of Adjustment, Account Stated and Judgment. The basic facts, which were stipulated are: Petitioner obtained a judgment in the District Court of the United States for the Southern District of California, Northern Division, against the District Director of Internal Revenue for a refund of income tax overpaid for the year 1944. *Karpe v. Riddell, supra.* Petitioner's complaint in *Karpe v. Riddell,* was based on his contention that the wrong basis was used in allocating the total income for 1944 between his separate income and his and his wife's community income under the laws of the State of California. The allocation had previously been made by assuming a fair salary for Pe-

titioner's personal services rendered in his business and a fair return on his separate property or capital used in his business. The ratio of each to the total of both was applied to the total income to determine the amount of community income and the amount of the separate income. Petitioner contended that the allocation should have been made by allowing a fair return on his separate capital to determine his separate income and that the balance of the total income was community income, taxable one-half to him and one-half to his wife. The District Court held that the formula used was the correct formula, but the Court changed the values to be used in applying the formula. The Court used eight percent instead of six percent as a fair return on Petitioner's separate capital and assigned Sixty Thousand Dollars ($60,000) instead of Twenty-Four Thousand Dollars ($24,000) as a fair salary for his personal services. These changes in the application of the formula resulted in an increase in the community income and a decrease in the separate income. Thus, Petitioner's taxable income was reduced and Petitioner's wife's taxable income was increased. Judgment was therefore rendered granting Petitioner a refund of income taxes paid for 1944. At the time the judgment became final, on February 18, 1957, the assessment of a deficiency against the wife of Petitioner was barred by Section 6501(a) of the Internal Revenue Code. 26 U. S. C. 6501(a). Thereafter, on August 2, 1957, Petitioner's wife was sent a statutory notice of deficiency. The

said notice stated in part: "The deficiency shown herein is asserted under the provisions of Section 1314 of the Internal Revenue Code of 1954 and corresponding provisions of the Internal Revenue Code of 1939." Petitioner's wife did not file a petition with the Tax Court of the United States and said notice became final on or about October 31, 1957. On December 6, 1957, the Internal Revenue Service issued a Notice of Adjustment to Petitioner showing a total overpayment due Petitioner of $140,113.58 and a payment of $83,081.70. The balance of the overpayment in the sum of $57,031.88 was shown as a credit in payment of the assessment made against Petitioner's wife's deficiency. It is for this latter sum that this action was instituted. Respondent, United States, filed an answer and an amended answer. It did not plead the mitigation sections in either its answer or amended answer. The Court of Claims held that by reason of the introduction of the statutory notice of deficiency into evidence by stipulation of the parties, containing the quoted statement, *supra,* the issue of whether or not the deficiency was properly assessed was at least tried by the implied consent of the parties and that, therefore, the mitigation sections were properly before the Court. The Court then held that the mitigation sections were to be construed liberally and under such construction, the sections applied. It then concluded that the assessment against Petitioner's wife was legally assessed and that Petitioner's petition be dismissed.

REASONS FOR GRANTING THE WRIT.

The decision below should be reviewed for the following reasons:

1. There is a direct conflict between the Court of Claims decision that the mitigation sections should be construed liberally and the decisions of Courts of Appeal for the Second Circuit and the Ninth Circuit and the Tax Court of the United States that said sections should be given a strict construction.
2. There is a direct conflict between the Court of Claims decision that the introduction of the statutory notice of deficiency into evidence places the mitigation sections in issue and the decision of the Tax Court of the United States that such introduction does not place the mitigation sections in issue.
3. Said conflicts are of such far reaching consequence in the proper and uniform interpretation and application of the Internal Revenue laws, that they should be resolved.

I.

Conflict With Respect to Construction of the Mitigation Sections.

The Court below recognized the existing conflict. ..... F. 2d ..... On page 11, in footnote 16 the Court said:

> "We are aware that a number of courts when called upon to apply these sections have adopted the view that since the sections are in derogation of the statute of limitations they should be strictly construed. E.g., *Central Hanover Bank & Trust*

Co. v. United States, 163 F. 2d 60, 63 (2d Cir. 1947); American Foundation Co., 2 T. C. 502 (1943). In the past we have characterized the mitigation statute as a 'relief provision' which 'should, if necessary, be given a liberal interpretation in order fully to carry out its apparent purpose.' *Gooch Milling & Elevator Co. v. United States, supra* at 587,178 F. Supp. at 100."

In *Central Hanover Bank & Trust Co. v. United States,* 163 F. 2d 60 (2d Cir., 1947) cited in the footnote quoted above, the Court of Appeals at pp. 62-63, stated:

> "That the terms of Section 3801(b)(5) were to be construed literally is indicated by Senate Report No. 1567, 75th Cong., 3d Sess., 20 Cum. Bull. 1939-1, Part 2, pp. 779, 815."

The Court then states at p. 64:

> "How very strict is the rule in dealing with the tolling of the bar of the statute of limitations in revenue cases is shown not only by the legislative interpretations, the Treasury Regulations, and the decision of the Tax Court in *American Foundation Co. v. Commissioner,* 2 T. C. 502, . . ., but by the recent decision of the Supreme Court in *Rothensies v. Electric Storage Battery Co.,* 329 U. S. 296, 67 S. Ct. 271, 273, where recoupment of barred claims was denied."

In *United States v. Rushlight,* 291 F. 2d 508 (9th Cir., (1961), in vacating the District Court judgment and remanding for further proceedings, the Court said at p. 514:

> "In allowing the application of Section 3801 to the adjustments sought by these taxpayers, the district court relied on its conception of the policy behind Section 3810, 'to provide a fair and workable formula under which taxpayers and the government would be given relief from the unfair and unjust results occasioned by corrections, by final determinations, or by errors of either the taxpayers or the Commissioner, or both.' Whatever may be the policy behind Section 3801, this statute does not purport to relieve against all inequities occasioned by the statute of limitations. One claiming the benefits of Section 3801 must assume the burden of proving its applicability. The district court should have required these taxpayers to meet the specific requirements of the statute and to bring themselves within one of the specified circumstances of adjustment."

Further, at p. 517, the Court stated:

> "The result which we reach is admittedly incongrous and inequitable."

The Court then points out that Congress made a mistake in drawing the mitigation sections which it corrected in 1954. The Court then says at p. 518:

> "This Court cannot correct the effects of that mistake prior to the enactment of the 1954 Code without rewriting the legislation, which we will not attempt to do under the guise of a 'liberal construction.'"

In *American Foundation Co. v. Commissioner,* 2 T. C. 502 (1943) (cited in footnote 16, *supra*), the Tax Court at p. 509 said:

"Section 3801 contains specific provisions governing its application, and we cannot extend those provisions by implication. *Gould v. Gould,* 245 U. S. 151."

In *D. A. MacDonald v. Commissioner,* 17 T. C. 934 (1951), the Tax Court at p. 939 stated:

"The respondent's determination of deficiencies in this proceeding was concededly made after the normal 3-year statute of limitations for assessment prescribed by Internal Revenue Code section 275-(a) had run. The determination, as stated in the notice of deficiency, was made under the provisions of Code section 3801. That section provides for an exception to the operation of the normal period of limitations for assessment by the Commissioner, or claim for refund by the taxpayer, when certain conditions exist. It does not obliterate the generally prescribed period for either assessment (Code section 275 (a)) or refund, (Code section 322 (b)). Basic in our tax system is a period prescribed by Congress upon which both the Government and the citizen may rely in the absence of exceptional circumstances which are recognized and provided for by statute. Speaking of statutes of limitation generally, the Supreme Court in *Rothensies v. Electric Storage Battery Co.,* 329 U. S. 296, said:

'It probably would be all but intolerable, at least Congress has regarded it as ill-advised, to have an income tax system under which there never would come a day of final settlement and which required both the taxpayer and the Gov-

ernment to stand ready forever and a day to produce vouchers, prove events, establish values and recall details of all that goes into an income tax contest. Hence a statute of limitation is an almost indispensable element of fairness as well as of practical administration of an income tax policy.'

"The intent of Congress in enacting section 3801 was in harmony with the thought expressed in the above quotation. This is clearly shown by the report of the Senate Finance Committee with respect to proposals that became section 820 of the Revenue Act of 1938, which is now Code section 3801 (S. Rept. No. 1567, 75th Cong., 3d sess., (1938) p. 49, 1939-1 C.B. (Part 2) 815) as follows:

'The legislation here proposed is based upon the following principles:

(1) To preserve unimpaired the essential function of the statute of limitations, corrective adjustments should (a) never modify the application of the statute except when the party or parties in whose favor it applies shall have justified such modification by active inconsistency, and (b) under no circumstances affect the tax save with respect to the influence of the particular items involved in the adjustment.'

"It is a rule long recognized that the party who invokes an exception to the basic statutory limitation period must plead it and assume the burden of proving all of the prerequisites to its application. *Farmers Feed Co.*, 10 B.T.A. 1069; *Bonwit Teller & Co.*, 10 B.T.A. 1300; *White Eagle Oil & Re-*

fining Co., 19 B.T.A. 185. See 34 Am. Jur., Limitation of Actions, section 451. In this proceeding, the respondent recognizes his burden and has attempted to meet it."

And further at page 940, the Court emphasizes the use of the word "item":

> "Section 3801, throughout its several subsections, provides for an adjustment as to 'an item' or 'items' with respect to which a determination has been made."

And at page 941:

> "See also the statement in the Finance Committee Report above quoted, that section 3801 is to be confined 'to the influence of the *particular items* involved in the adjustment."

(Acquiesced Cum. Bull. 1952-1, p. 3.)

The Court of Claims, on the other hand, and in direct conflict with the foregoing cases, in construing the mitigation sections liberally, states in the instant case ..... F. 2d ....., at pages 11 and 12:

> "Plaintiff's argument that before an amount of gross income can be an 'item' of gross income within the meaning of section 1312 it must be reflected as a separate entry in the taxpayer's tax return, is too restrictive to carry out the apparent congressional intent.[16] We believe that Congress intended us to view an 'item' of gross income as anything 'specific and identifiable' by which such income is 'directly affected'."

And at p. 11, it states:

> "We do not think that the statutory word 'item' should be given such a limited interpreta-

tion. In *Gooch Milling & Elevator Co. v. United States,* 111 Ct. Cl. 576, 586, 78 F. Supp. 94, 100 (1948), we described an 'item' as follows:

> * * * The term 'item' was not defined or limited by Congress, and in our opinion it should be interpreted to include any item or amount which affects gross income in more than one year, and produces, as a result, double taxation, double deduction or inequitable avoidance of tax."

In its footnote 16, p. 12, the Court says:

> "We believe that they were enacted with the view that 'disputes as to the year in which income or deductions belong [and in this case disputes as to which of two related taxpayers should include amounts of gross income] * * * should never result in a double tax, or a double deduction of tax or an inequitable avoidance of tax." S. Rep. No. 1567, 75th Cong., 3d Sess., 49-50 (1938)."

In *Gooch Milling & Elevator Co. v. United States, supra,* 78 F. Supp. 94, 99-100, the Court of Claims said:

> "In support of this position it is insisted that in referring to 'an item' of income or deduction erroneously included or excluded, Congress had in mind specific identifiable items of income or items of deduction which produce inequitable results through inconsistent treatment, occasioned by the transfer thereof from one year to another; that the term 'item' used in subsection (b), has reference only to such specific identifiable items as dividends, salaries, a profit on the sale of specific property, a loss or bad debt.

> We think, upon further consideration, that the section should not be given such a limited interpretation."

And further at p. 100:

> "As we have said, Section 820 is a relief provision and, therefore, it should, if necessary, be given a liberal interpretation in order fully to carry out its apparent purpose."

To the same effect are the Court of Claims decisions in *H. T. Hackney Co. Inc. v. United States,* 111 Ct. Cl. 664, 78 F. Supp. 101 (1948) and *M. Fine & Sons Manufacturing Co. v. United States,* 144 Ct. Cl. 46, 168 F. Supp. 769 (1959), and the Court of Appeals for the Fifth Circuit in *Gill v. Commissioner,* 306 F. 2d 902 (1962).

It is respectfully submitted that this direct and serious conflict should be resolved.

II.

Conflict With Respect to Mitigation Sections Being Put in Issue by Introduction of Statutory Notice of Deficiency Into Evidence.

The Court of Claims, in answer to Petitioner's contention that by the failure of the United States to plead the mitigation sections in its answer, it could not invoke said sections as a defense, said:

> "Rule 22(b), formerly Rule 18, of the Rules of this court, states in pertinent part, as follows:
>
> When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendments of the pleadings as may be neces-

sary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend does not affect the result of the trial of these issues.

"At the trial the parties through their respective counsel entered into an agreement whereby they stipulated to certain facts. One of their stipulations states in pertinent part, as follows:

> On August 2, 1957, Birda M. Karpe [cross-defendant] was sent a statutory notice of deficiency, a copy of which is attached as Exhibit B.

Attached to the standard form statutory notice of deficiency and part of joint exhibit B is a statement which, in part, states as follows:

> The deficiency shown herein is asserted under the provisions of section 1314 of the Internal Revenue Code of 1954 and corresponding provisions of the Internal Revenue Code of 1939.

Under these circumstances, it is fair to say that the issue whether or not cross-defendant's deficiency was *properly* assessed within the provisions of the mitigation sections, was at least tried by the implied consent of the parties. The record, as shown above, clearly established that cross-defendant's deficiency was asserted under the provisons of section 1314 of the 1954 Code. Consequently, the mitigation sections are properly before us and there is no procedural obstacle which prevents us from passing on the merits of this issue."

Karpe v. United States, ... F. 2d .....

This holding by the Court of Claims is in direct conflict with *C. A. Reis v. Commissioner,* 1 T. C. 9,

a case involving the five-year statute under Section 275(c) of the Revenue Act of 1936. The Court, in stating the issue, said at pp. 10, 11:

> "Though the deficiency notice was introduced, it was only for the limited purpose of showing the manner in which the Commissioner computed the basis allowed in arriving at the deficiency. It does not constitute evidence of the gross income 'stated in the return,' or of the amount 'properly includible' in gross income which was omitted from the return. *Emma B. Maloy,* 45 B.T.A. 1104. It does not show nor indicate the gross income stated in the return. Neither party relies upon the deficiency notice for such proof. The difference between them is that each urges that the burden of proof was upon the other, and that, the record not showing the requisite proof, he should prevail. The question, therefore, for our solution is: Who has the burden of proof? The petitioner argues, in short, that the respondent failed to adduce evidence to comply with his burden of showing an exception to the three-year rule provided in section 275(a); the respondent's position appears to be that the burden of proof is upon the petitioner, because he determined in the deficiency notice that the plea of limitations under section 275(a) 'is denied. It is held that timely assessment of the deficiencies may be made under the provisions of Section 275 (c) of the said Revenue Acts'; and because his determination in that respect is prima facie correct and it is incumbent on the petitioner to show otherwise by showing that he did not omit from his return 25 percent of gross income properly includible."

In answering the issue, the Court stated at p. 13:

> "We are unable to conceive that the presumption of the correctness of a deficiency notice, which in the ordinary case the petitioner must meet, was intended by Congress to be used as a substitute for evidence in a case where the respondent has the burden of proof as here he has under the various cases first above cited. To adapt a classic to the case, the deficiency notice is a shield, not a sword. It is a defense where the petitioner has the onus of proof, not a weapon where the respondent has the burden. The respondent, under the theory he advances here, might with equal logic contend that he could escape the burden of proof of fraud in a case involving fraud, under section 293 (b), or the burden of proving that a return was 'false and fraudulent * * * with intent to evade tax' under section 276 (a), of the various revenue acts, merely by making a determination of fraud or fraudulent intent to evade tax. Yet, under all decisions he can not so escape his burden. The fact that the burden is in some instances placed upon the respondent by statute does not distinguish such cases from the instant matter. The burden is upon the respondent, whether by statute or the decisions above cited; he cannot evade it by mere determination of the very facts upon which the Court must pass."

While in the instant case, the Court below ruled on the use of the statutory notice to avoid the necessity of pleading and in *C. A. Reis, supra,* the Court ruled on the use of the statutory notice to avoid the burden of proof, the cases must be held to be in conflict, for the

reason that the party who invokes an exception to the basic statutory limitations period must plead it and assume the burden of proving its application. Therefore it must follow that if it can be used to avoid the one its use is applicable to avoid the other. Conversely, if it can not be used to avoid the other.

D. A. MacDonald, supra, 17 T. C. 934 at 940

III.

Said Conflicts Should Be Resolved in Order That There Can Be Proper and Uniform Interpretation and Application of the Internal Revenue Laws.

It is basic to the proper administration of the Internal Revenue Laws, that they be uniformly construed and applied. Indeed, as stated in Vol. 1, Prentice-Hall, Federal Taxes, par. 2700, p. 2701:

> "Occasionally, one Circuit of the United States Court of Appeals will interpret a law differently from another Circuit. This is one of the primary reasons for which the Supreme Court reviews decisions, to settle a conflict between the Circuits. A conflict may also develop between the Court of Claims and a Circuit of the United States Court of Appeals."

See:

United States Supreme Court, Rule 19.1(b), 2.

To permit the conflict referred to, *supra,* to continue, will permit taxpayers or the Internal Revenue Service to pick the forum which they believe will be most favorable, depending on whether they believe a liberal construction or a strict construction of the miti-

gation sections will benefit them most. This condition should not be allowed to continue. It appears that the only way this condition can be corrected is for this Honorable Court to grant this petition and resolve the conflict.

Conclusion.

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

ARMOND M. JEWELL,
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Of Counsel:
LLOYD G. RAINEY,
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APPENDIX.

Opinion and Judgment of Court of Claims.

In the United States Court of Claims.

A. H. Karpe v. The United States; The United States (Cross-Complainant) v. Birda M. Viera (Cross-Defendant) No. 161-59 (Decided July 17, 1964).

J. Everett Blum for plaintiff. *Lloyd G. Rainey* on the brief.

Stephen E. Wall for third party, *Birda M. Viera. Baker, Palmer, Wall & Raymond* on the brief.

Cynthia Holcomb, with whom was *Assistant Attorney General Louis F. Oberdorfer,* for defendant. *Edward S. Smith, Lyle M. Turner* and *Philip R. Miller,* on the brief.

Before Jones, *Senior Judge,* Whitaker, Laramore, Durfee and Davis, *Judges.*

Laramore, *Judge,* delivered the opinion of the court:

This is a suit by plaintiff, A. H. Karpe, to recover $55,868.05 in income taxes, plus interest, for the year 1944, which were assessed against cross-defendant, Birda M. Viera, but paid by plaintiff by means of crediting his over-assessment to her deficiency. The first question presented in this case is whether the mitigation statutes, sections 1311-1315 of the Internal Revenue Code of 1954, permit the assessment of the deficiency against cross-defendant. In the event the taxes were properly assessed, then we must determine whether plaintiff was obligated to pay the resulting deficiency under the terms of a property settlement agreement entered into between plaintiff and cross-defendant, his foremer wife. In connection with this second

issue, plaintiff has raised the defense that cross-defendant by her failure to fully cooperate in contesting the assessed deficiency breached the agreement, thus relieving plaintiff of his obligation to pay the additional taxes.

During the year in issue, 1944, plaintiff and cross-defendant were husband and wife living in California, a community property state.[1] In preparing their separate Federal income tax returns for that year, they divided family income between separate and community by applying the formula approved in *Parker v. Commissioner,* 31 B.T.A. 644 (1934). Under that formula, 69.2 percent of the total family income was ultimately reported by plaintiff as separate income and the remaining 30.8 percent was considered community income reportable one-half by each spouse. Cross-defendant did not have any separate income for the year in issue.

In 1949 the Commissioner of Internal Revenue discovered that plaintiff had fraudulently failed to include $225,000 as income in his 1944 Federal income tax return. As a result of the discovery of this fraudulently omitted income, the Commissioner assessed plaintiff additional taxes, fraud penalties, and interest. In so doing, the Commissioner allocated to plaintiff 69.2 percent of the unreported income as separate income and 30.8 percent as community income, one-half reportable by plaintiff. The Commissioner also in 1949 assessed cross-defendant a deficiency on the resulting increase

[1]Under California law the salaries of the spouses are community property, owned one-half by each spouse, but capital acquired prior to the marriage and the earnings it produces during the marriage are the separate property of the spouse owning the capital. Cal. Civil Code §§ 163-164.

in her share of the community income. The manner in which the omitted income was allocated by the Commissioner among separate and community income was in conformity with the formula used by plaintiff in his 1944 tax return. The resulting deficiency, interest, and fraud penalties were paid by the parties in 1949 and 1950.

Plaintiff in 1954 instituted a suit for refund in the U. S. District Court for the Southern District of California claiming that a larger portion of the family income for the year in issue was community income reportable one-half by each spouse rather than separate income reportable solely by him.[2] The basis for his claim was that the income derived from his business "was primarily due to his personal activities, management, skill, judgment and hard, work,"[3] and thus constituted community income. Plaintiff further contended that his separate income was to be determined under controlling California law[4] by crediting his separate capital, *i.e.*, that amount of capital which was employed in his business at the time of his marriage, "with the usual rate of interest prevailing during the subject period on a well secured long-term investment."[5] Under his theory, the excess of family income left after

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[2]The net effect of plaintiff's claim would be to reduce his total income, thereby reducing the amount by which it was fraudulently understated and reducing the companion interest and fraud penalties assessed against plaintiff. Cross-defendant was not chargeable with fraud and no fraud penalty was assessed against her.

[3]Plaintiff's brief in *Karpe v. Riddell,* No. 1357-N.D.—Civil, p. 11.

[4]The ownership of income in a community property state is to be determined under state law. *Poe v. Seaborn,* 282 U.S. 101 (1930); *United States v. Malcolm,* 282 U.S. 792 (1931).

[5]*Supra,* footnote 3 at p. 12.

his separate capital had been credited with the appropriate rate of return, constituted community income since this excess was wholly due to the unique and extraordinary nature of his personal services performed in the production of that income.

The District Court partially agreed with plaintiff that a larger portion of the family income for the year in issue was community income rather than separate income as originally reported by plaintiff and allocated by the Commissioner of Internal Revenue.[6] The trial court determined that $60,000 of the family income was attributable to plaintiff's "personal services and labors in the conduct of his farming ventures and farm equipment business."[7] Then the court found that "a return before income taxes of eight percent per annum on invested capital is reasonable and could be expected from an investment in a business like that of the plaintiff for the year 1944."[8] The court went on and determined that since the return on his separate capital plus the amount allocated as remuneration for his services was less than the total family income, the excess was "in large part attributable to intangibles" constituting both separate and community income. The court used the *Parker* formula to allocate this excess in the same proportion as the computed separate and community income bear to each other.[9] Thus under the District Court's decision, only 50.77 percent of the family income was plaintiff's separate income as compared to 69.2 as originally reported, and 49.23 percent of the family income was community income, reportable one-

[6] *Karpe v. Riddell*, 51 A.F.T.R. 1522 (1956).
[7] *Id.* at 1523.
[8] *Ibid.*
[9] *Ibid.*

half by each spouse, instead of the 30.8 percent originally used. The result of the determination was that plaintiff's separate income was decreased with the concomitant increase in the community income reportable one-half by each spouse. As a consequence of this reallocation of the parties' family income, plaintiff had a total overpayment of about $97,000 including both fraud penalties and interest.[10] Since the District Court's determination increased the amount of family income which was considered community income, cross-defendant's share of that income increased with the result that she underpaid her taxes for the year in issue in the sum of about $55,000.

Within six months after the District Court's decision became final, cross-defendant was sent a statutory notice of deficiency proposing an assessment of additional taxes for the year 1944 under the mitigation provisions of the Internal Revenue Code of 1954. Cross-defendant failed to file a petition in the Tax Court within 90 days after receipt of the statutory notice of deficiency. Plaintiff's overassessment for 1944, as determined by the District Court, was credited in payment of cross-defendant's resulting deficiency. The balance of plaintiff's overassessment for that year was refunded to him. The government by crediting plaintiff's overassessment in payment of cross-defendant's resulting deficiency, purported to act pursuant to the property settlement agreement entered into between plaintiff and cross-defendant, in which it was provided,

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[10]Under the District Court determination plaintiff overpaid his taxes in the sum of about $55,000, his fraud penalty in the sum of about $28,000, and his interest in the sum of about $14,000.

inter alia, that plaintiff would pay any tax deficiencies assessed against either of them for the years of their marriage.[11]

In 1959 plaintiff filed this suit on the judgment he had obtained in the District Court,[12] claiming that (1) the statute of limitations for the assessment and collection against cross-defendant for the year 1944 had run. (In connection with this contention, plaintiff asserts that by defendant's failure to specifcally plead the application of sections 1311 through 1314 of the Internal Revenue Code of 1954, which in certain prescribed circumstances mitigates the bar of the statute of limitations, it has not placed said sections in issue before the court and, therefore, cannot avail itself of the provisions to justify what would otherwise be a time-barred assessment); (2) even if the mitigation sections are properly before us, their provisions are not applicable in the instant case, since (a) the District Court's determination did not require a double exclusion of an item of gross income as required by section 1312 (3)(A) which prescribes those circumstances under which the application of the statute of limitations is mitigated by section 1311, and (b) the District Court in its determination did not adopt plaintiff's inconsistent position as required by section 1311(b)(1)(B); (3) in the event that the mitigation sections are applicable to the instant case, defendant cannot use the property settlement agreement entered into by plaintiff and cross-defendant for authority to credit his overassessment with cross-defendant's resulting deficiency; (4) in the event

[11]The pertinent parts of the agreement are fully set out in our findings of fact numbered 22 and 23.

[12]Plaintiff first filed suit in the U.S. District Court where the complaint was dismissed for lack of jurisdiction.

that under the property settlement agreement defendant could properly credit his overpayment, cross-defendant by her failure to cooperate fully in contesting the assessed deficiency breached the agreement, thus relieving plaintiff of his obligation to pay the additional taxes.

I

We address ourselves first to plaintiff's procedural issue. Plaintiff raises the contention that by defendant's failure to specifically plead the application of sections 1311 through 1314 of the 1954 Code, it cannot now invoke said sections as an exception to the application of the statute of limitations as a bar to the assessment of cross-defendant's deficiency for the year in issue.

Rule 22(b), formerly Rule 18, of the Rules of this court, states in pertinent part, as follows:

> When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendments of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend does not affect the result of the trial of these issues.

At the trial the parties through their respective counsel entered into an agreement whereby they stipulated to certain facts. One of their stipulations states in pertinent part, as follows:

> On August 2, 1957, Birda M. Karpe [cross-defendant] was sent a statutory notice of deficiency, a copy of which is attached as Exhibit B.

Attached to the standard form statutory notice of deficiency and part of joint exhibit B is a statement which, in part, states as follows:

> The deficiency shown herein is asserted under the provisions of section 1314 of the Internal Revenue Code of 1954 and corresponding provisions of the Internal Revenue Code of 1939.

Under these circumstances, it is fair to say that the issue whether or not cross-defendant's deficiency was *properly* assessed within the provisions of the mitigation sections, was at least tried by the implied consent of the parties. The record, as shown above, clearly established that cross-defendant's deficiency was asserted under the provisions of section 1314 of the 1954 Code. Consequently, the mitigation sections are properly before us and there is no procedural obstacle which prevents us from passing on the merits of this issue.

II

We turn now to the merits of the application of sections 1311 *et seq.* of the 1954 Code. These provisions were designed to mitigate the bar of the statute of limitations on either an assessment by the government or a refund to the taxpayer where the statute of limitations would serve to create either a double taxation or a double escape from taxation. Section 1311(a)[13]

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[13]Section 1311(a) reads as follows: "(a) *General Rule.*—If a determination (as defined in section 1313) is described in one or more of the paragraphs of section 1312 and, on the date of the determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented

sets forth the basic conditions which have to be met for the operation of the mitigation sections. They are as follows: (1) there must be a determination as defined in section 1313, (2) the determination must come within one of the categories described in section 1312 as a circumstance of adjustment, (3) correction of the effect of the error by means of the normal procedures must be prevented, and (4) an inconsistent position must have been asserted in the manner described in section 1311(b). If these conditions are met, then the amount of the adjustment must be computed in accordance with section 1314(a) and the adjustment must be made in the manner prescribed in section 1314(a).

In the instant case, there is no dispute that conditions (1) and (3) have been met. The District Court's judgment in *Karpe v. Riddell, supra,* which became final on February 18, 1957, is a determination within the meaning of section 1313(a)(1). On the date that this judgment became final, the assessment of the resulting deficiency in cross-defendant's income for 1944 was prevented by the statute of limitations. The controversy between the parties is with respect to conditions (2) and (4).

The government contends that the circumstance of adjustment in the case is the double exclusion of an item of gross income as described in section 1312(3)(A):

> (3) *Double exclusion of an item of gross income.*—

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by the operation of any law or rule of law, other than this part and other than section 7122 (relating to compromises), then the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in section 1314."

> (A) *Items included in income.*—The determination requires the exclusion from gross income of an item included in a return filed by the taxpayer or with respect to which tax was paid and which was erroneously excluded or omitted * * * from the gross income of a related taxpayer [cross-defendant] * * *.

The area of dispute[14] between the parties centers on the meaning of the statutory word "item" of gross income contained in section 1312(3)(A). Plaintiff argues that the determination made by the District Court was merely to change the division between separate and community income. Plaintiff points out that no single item of income reported in plaintiff's income tax return filed for the year 1944 or added by audits of said return was involved in the District Court suit. Plaintiff goes on and states that "[t]he sole issue was the correctness of the division of all of the gross income between separate income and community income."[15] Plaintiff seems to argue that the statutory word "item," as used in section 1312(3)(A) is strictly a qualitative one, synonymous with "type." Thus, under plaintiff's argument, before an amount of gross income can be an "item" of gross income within the

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[14]There is no dispute that cross-defendant is a "related taxpayer" as prescribed in section 1313(c) which defines related taxpayer as

> ". . . a taxpayer who, with the taxpayer with respect to whom a determination is made, stood, in the taxable year with respect to which the erroneous inclusion, . . . was made, in one of the following relationships:
> (1) husband and wife . . ."

During the year 1944 plaintiff and cross-defendant were husband and wife.

[15]Plaintiff's reply brief, p. 4.

meaning of section 1312, the amount must be reflected as a separate entry (a sum specified) in the taxpayer's tax return for the year in issue.

We do not think that the statutory word "item" should be given such a limited interpretation. In *Gooch Milling & Elevator Co. v. United States,* 11 Ct. Cl. 576, 586, 78 F. Supp. 94, 100 (1948), we described an "item" as follows:

> * * * The term "item" was not defined or limited by Congress, and in our opinion it should be interpreted to include any item or amount which affects gross income in more than one year, and produces, as a result, double taxation, double deduction or inequitable avoidance of tax.

Accord: *Gill v. Commissioner,* 306 F. 2d 902, 906 (5th Cir. 1962), (citing the above-quoted language with approval); *Dubuque Packing Co. v. United States,* 126 F. Supp. 796 (N.D. Iowa 1954), aff'd 233 F. 2d 453 (8th Cir. 1956).

Plaintiff's argument that before an amount of gross income can be an "item" of gross income within the meaning of section 1312 it must be reflected as a separate entry in the taxpayer's tax return, is too restrictive to carry out the apparent congressional intent.[16] We

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[16]We are aware that a number of courts when called upon to apply these sections have adopted the view that since the sections are in derogation of the statute of limitations they should be strictly construed. *E.g., Central Hanover Bank & Trust Co. v. United States,* 163 F. 2d 60, 63 (2d Cir. 1947); *American Foundation Co.,* 2 T.C. 502 (1943). In the past we have characterized the mitigation statute as a "relief provision" which "should, if necessary, be given a liberal interpretation in order fully to carry out its apparent purpose." *Gooch Milling & Elevator Co. v. United States, supra,* at 587, 78 F. Supp. at 100. It has been suggested, however, that "an analysis of cases suggests that the potentiality for error latent in the con-

believe that Congress intended us to view an "item" of gross income as anything "specific and identifiable" by which such income is "directly affected."[17] Under our postulated test, the District Court's determination clearly "directly affected" plaintiff's and cross-defendant's total gross income for the year in issue; it reduced plaintiff's total income with the concomitant increase in cross-defendant's total income for that year. There is no doubt that the source of this amount was "specific and identifiable." The District Court's determination required that part of those amounts which have been previously classified as separate income and reported solely by plaintiff be included in the parties' community income reportable one-half by each spouse.

Thus it can be seen that although as plaintiff correctly points out that the District Court was primarily concerned with the proper division of the parties' separate and community income, the effect of that division was to require "the exclusion from gross income of an item included in a return filed by the taxpayer or with

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scious adoption of either general canon weighs in favor of subordinating both to a more particularized and purposive interpretive technique." Note, 72 Harv. L. Rev. 1536, 1546-47 (1959). We agree that the application of the mitigation sections should not be sustained or denied merely on the basis of the interpretive philosophy adopted by the court. However, the complexity of the sections (see Judge Clark's comments in *Cory v. Commissioner*, 261 F. 2d 702, 704 (2d Cir. 1958), and the inexactness with which such key terms as "items of income" are defined and used, require us to use as a starting point of our analysis the apparent congressional intent in enacting these sections. We believe that they were enacted with the view that "disputes as to the year in which income or deductions belong [and in this case disputes as to which of two related taxpayers should include amount of gross income] . . . should never result in a double tax, or a double deduction of tax or an inequitable avoidance of tax." S. Rep. No. 1567, 75th Cong., 3d Sess., 49-50 (1938).

[17]See Knickerbocker, *Mysteries of Mitigation: The Opening of Barred Years in Income Tax Cases*, 30 Fordham L. Rev. 225, 241 (1961) where the author states that such an interpretation "is not only reasonable but correct."

respect to which tax was paid (one-half of the amount determined to be community income which had previously been reported as separate income) and which was erroneously excluded or omitted from the gross income of a related taxpayer [cross-defendant]."

Thus we hold that the amount of income which was excluded from plaintiff's gross income and which was required to be included in the gross income of cross-defendant was an "item" of gross income within the meaning of section 1312. It follows that the determination in the instant case comes within the "circumstances of adjustment" described in section 1312(3)(A)).

We turn now to the last condition which has to be met before the mitigation sections can be properly invoked., Section 1311(b)(1)(B) in pertinent part requires that an adjustment shall be made under this part only if—

> (B) in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under section 1314, there is adopted in the determination a position maintained by the taxpaper with respect to whom the determination is made, and the position . . . maintained by the taxpayer in the case described in subparagraph (B)

is inconsistent with the erroneous . . . omission. There is no doubt that plaintiff in the District Court suit maintained an inconsistent position.[18] The prob-

[18]The position maintained by plaintiff in the District Court proceedings was that he had included certain community income in his return (which he had erroneously categorized as his separate income) which should not have been included in his return but should have been included in his wife's return. This was inconsistent with the erroneous omission of that very community income from the wife's return.

lem here is whether the court making its determination *adopted* plaintiff's inconsistent position.[19]

Plaintiff argues in effect that the statute requires that the court making the determination not only reach the same *result* as that urged by plaintiff, but that in so doing, it must adopt plaintiff's *theory* as a basis for the result urged. Plaintiff then contends that the District Court in partially granting the result which he urged did not adopt plaintiff's theory since it continued to use the *Parker* formula in allocating separate and community income.

At the outset, it should be pointed out that the requirement of section 1311(b)(1) is that the determination adopt a position inconsistent with the *error*[20] and that this position must have been actively maintained by the party seeking to interpose the bar of the statute of limitations.[21] See *Dobson v. United States,* Ct. Cl. No. 401-62, decided April 17, 1964, slip op., p. 6, 320 F. 2d 646, 650 (concurring opinion by Laramore, J.). It also appears that the requirement of the statute is not satisfied if the court making the determination merely reaches the same result which had been urged

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[19]Section 1311(b)(3) requires the existence of the relationship of related taxpayer, here husband and wife, at the time the plaintiff first maintains the inconsistent position in a claim for refund. The claim for refund referred to is that filed by plaintiff on March 25, 1952, or five years before plaintiff and cross-defendant ceased to be husband and wife.

[20]See *Knickerbocker, supra,* note 17 at 239.

[21]The essential function of the statute of limitations, *i.e.,* the prevention of the litigation of stale claims was preserved when Congress enacted the mitigation sections since the bar of the statute is removed only when "the party or parties in whose favor it applies shall have justified such modification by active inconsistency." S. Rep. No. 1567, 75th Cong., 3d Sess., 49 (1938). See *Note, Sections 1311-15 of the Internal Revenue Code: Some Problems in Administration,* 72 Harv. L. Rev. 1536, 1538 (1959).

by the party who now seeks to interpose the bar of the statute of limitations. We believe that the stautory word "position" is not synonymous with result. The drafters by using the word "position" seem to have required that the court making the determination not only grant the result urged but also adopt the party's general theory as a basis for reaching this result. See *Estate of A. W. SoRelle,* 31 T.C. 272, 275 (1958).

With this in mind, we shall examine what transpired in the District Court proceedings. It is clear that the determination by the District Court partially granted the result urged by plaintiff, *i.e.,* that for the year 1944 he had overstated his income since he had included amounts of income which should have been included in his wife's return. Plaintiff's theory for reaching the result urged was that a greater portion of the family income was primarily due to the extraordinary nature of his personal services performed in the production of that income, and as such should be community income rather than return of his separate invested capital reportable solely by him as separate income. The District Court partially sustained his theory that a portion of the family income which had been previously reported as separate income was not a return of his separate invested capital but was rather community income primarily due to his personal services. In the District Court proceedings both parties agreed that a determination of what constitutes community income or separate income is essentially a question of fact. However, the District Court found that not all the family income which plaintiff urged to be due to his personal services was community income. The court found that part was due to the return of his separate invested capital and the excess was in

large part attributable to intangibles constituting both separate and community income. The court then allocated this excess by the use of the *Parker* formula.

We agree with plaintiff that section 1311(b)(1) requires not only that the court making the determination reach the same result but also that it adopt plaintiff's general theory as a basis for reaching the result urged. However, plaintiff in his argument misconceives what was the result which he urged and what was his theory supporting that result. Here the result urged was that plaintiff overstated his income for the year 1944, since he included in his gross income amounts which should have been included in his wife's return. The theory which plaintiff urged in support of that result was that a larger amount of the family income should have been determined to be community income since such income was due to his personal services. The District Court partially agreed with him that a larger amount should be community income. Thus it can be said that the District Court not only partially reached the result urged by taxpayer but also adopted his theory as a basis for that result.

The fact that the District Court continued to use the *Parker* formula in order to allocate separate and community income should not be determinative. The *Parker* formula is not a legal theory *but* a device used for the allocation of income. Theoretically once the return on separate invested capital and a reasonable compensation for personal services have been determined and taken out of the family income, there should be nothing left. However, such a precise valuation is often impossible.[22]

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[22]See G.C.M. 1030 VI-I Cum. Bull. 26 (1927); G.C.M. 9825 X-2 Cum. Bull. 146 (1931).

Thus, in those circumstances where there is an excess of family income, the *Parker* formula comes into play. This formula recognizes the fact that this excess is often the result of unrecorded intangibles and intrinsic circumstances. Accordingly, it distributes such excess prorata between separate and community income. Had the District Court completely applied plaintiff's theory to all amounts of family income, resort to the *Parker* formula would have been unnecessary, since plaintiff urged that once a reasonable return for separate invested capital was determined, the excess of the family income was solely due to his personal services. However, the District Court only partially agreed with him with the result that there was an excess of family income and the *Parker* formula was used to allocate the excess. Consequently, we must hold that plaintiff's position was adopted by the District Court in its determination and that this position was inconsistent with erroneous omission from cross-defendant's gross income. Accordingly, the mitigation provisions of the Internal Revenue Code were properly invoked and cross-defendant's deficiency was legally assessed.

III

Having determined that cross-defendant's deficiency for the year 1944 was properly assessed under the mitigations sections, we return to the issue whether the government could properly credit plaintiff's overassessment with cross-defendant's deficiency.

As stated earlier, while plaintiff's District Court action was still pending, he entered into a property settlement agreement with his wife, preparatory to their subsequent divorce, in which it was provided, among

other things, that plaintiff would pay any tax deficiencies assessed against either of them for the years of their marriage.

The government argues that under the property settlement agreement it was a third party beneficiary and as such, it could collect cross-defendant's taxes from plaintiff. The government's right as third party beneficiary to collect another's taxes from an individual promising to pay them has been recognized in a number of occasions. *E.g., United States v. Phoenix Indemnity Co.*, 231 F. 2d 573 (4th Cir. 1956); *United States v. Scott*, 167 F. 2d 301 (8th Cir. 1948); *American Equitable Assurance Co. v. Helvering*, 68 F. 2d 46 (2d Cir. 1944). It is equally true that under California law, the third party beneficiaries can enforce contracts made for their benefit. Cal. Civil Code, section 1559. Moreover, the contract creating the rights accruing to the third party beneficiary need not do so in express language. Corbin on Contracts, section 776 (pp. 23-24).

Under the parties' settlement agreement, plaintiff contracted with cross-defendant for consideration to pay any tax deficiency assessed against her for the years of their marriage. This agreement was entered into while the District Court suit was still pending. We believe that this clause in the settlement agreement was inserted by the parties to take care of the exact situation which confronts us. It is clear that under the agreement, the United States became a third party beneficiary. As stated earlier, the rights of third party beneficiary are enforceable under California law. It follows that the government, as a third party benefi-

ciary with enforceable rights against plaintiff, could apply moneys due plaintiff and held by it in satisfaction of cross-defendant's debt to it.

Plaintiff argues that the case of *Philadelphia Rapid Transit Co. v. United States,* 81 Ct. Cl. 289, 10 F. Supp. 591 (1935), cert. denied 300 U. S. 664 (1936), requires a contrary result. In that case we were concerned with a completely different issue. Plaintiff here is not liable because he is the taxpayer, but because he contracted to pay cross-defendant's debt. In *Philadelphia Rapid Transit,* the rights of the government as a third party beneficiary were assumed by both parties. In that case we held since plaintiff and its lessor were separate taxpayers, the application of plaintiff's overpayment to its lessor's deficiency should not be treated for interest purposes as a statutory credit (occurring where a taxpayer's overpayment is applied to his own deficiency) but should be treated as a refund of plaintiff's overpayment followed by a turning over of the same funds in payment of the taxes of another. In the instant case we are concerned with the threshold issue of whether the government had any enforceable rights as a third party beneficiary while in *Philadelphia Rapid Transit* the government's rights were assumed by both parties.

Since we have determined that the government became a third party beneficiary under the settlement agreement, we hold that it was appropriate for it to apply a portion of moneys due him to his former wife's deficiency.

IV

Finally, plaintiff asserts that he was relieved of any obligation under the property settlement agreement be-

cause of an alleged breach of contract by his former wife. Specifically, plaintiff contends that cross-defendant's failure to deliver promptly the documents dealing with the tax deficiency assessed against her relieve him of any obligation to pay her tax. It appears that the only detriment which plaintiff suffered was that he was unable to have cross-defendant's assessment judicially determined in the Tax Court. However, it is clear that plaintiff or his representatives were aware that additional taxes had been asserted against cross-defendant long before the period for petitioning the Tax Court had expired. If plaintiff was so interested in having the litigation judicially determined in the Tax Court, he could have taken protective measures to safeguard his rights in this respect.

Our Commissioner has found that even if the alleged breach occurred, it has occasioned no loss of rights to plaintiff and no damage measurable in money.

Consequently, we must hold that cross-defendant's alleged breach of contract, if there was any, did not relieve plaintiff of the obligation to pay the additional taxes.

Since we have determined that the assessment made against cross-defendant was properly made pursuant to the provisions of section 1311 *et seq.* of the Internal Revenue Code of 1954 and that under the property settlement agreement, the United States government, as third party beneficiary with enforceable rights under such an agreement, properly credited plaintiff's overassessment with cross-defendant's deficiency, plaintiff's petition is dismissed.

FINDINGS OF FACT

The court, having considered the evidence, the report of Trial Commissioner Paul H. McMurray, and the briefs and argument of counsel, makes findings of fact, as follows:

1. This is a suit by plaintiff to recover tax in the amount of $55,868.05, plus interest at 6 percent from April 30, 1957, originally assessed against his wife (cross-defendant in this action), abated on May 24, 1957, and later assessed against plaintiff. Plaintiff, Arthur Henry Karpe, is a resident of Kern County, California. Cross-defendant, Birda Marie Viera, is a resident of San Bernardino, California. Plaintiff and cross-defendant were husband and wife from November 19, 1938, to June 27, 1957, on which date a final decree of divorce was granted Birda Marie Karpe against plaintiff. She subsequently married Manuel Viera.[23]

2. During 1907 plaintiff entered into business as a blacksmith in Bakersfield, California, with a capital investment of less than $100. At the time he married cross-defendant, hereinafter referred to as Birda Marie, he owned a profitable machinery, truck, and farm implement sales and repair business known as Karpe's Implement House, which was the exclusive International Harvester outlet for Kern County. Prior to his mar-

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[23]One question involved is whether the tax was properly assessed within the provisions of sections 1311 and 1315 of the Internal Revenue Code of 1954, and the corresponding provisions of the 1939 Code. A second question, assuming the assessment was properly made, relates to plaintiff's obligation, if any, to pay additional taxes of cross-defendant (his wife at the time) for the calendar year 1944 under terms of a property-settlement agreement entered into between plaintiff and his wife prior to the divorce.

Also involved is the matter of a possible breach of the agreement by cross-defendant in such fashion as would make her liable to pay the additional taxes for 1944.

riage to Birda Marie, plaintiff also had entered into farming ventures, primarily on leased land. Plaintiff claimed his net worth was about $550,000 at the time of his marriage to Birda Maria in 1938.

3. For the calendar year 1944 plaintiff and Birda Marie, his wife at that time, filed separate income tax returns on or before March 15, 1945, and paid the tax shown to be due on the returns.

4. In his 1944 Federal income tax return plaintiff fraudulently failed to include income from sales of wheat in that year amounting to $225,000. The sales of the wheat were not reflected in any figure on that return or schedules attached thereto, or in any account in the plaintiff's books, records, or accounts for the year in which it was grown or the year in which it was harvested or for any subsequent year. The wheat was grown on acreage in excess of plaintiff's quota set by the U.S. Department of Agriculture for the respective years in which the wheat was grown and harvested.

5. In his return for the year 1944, the plaintiff allocated his total income as between his separate income and the community income of plaintiff and his wife, Birda Marie, by the use of the type of formula approved in *Parker v. Commissioner,* 31 B.T.A. 644, using a 6 percent return on separate capital and a $24,000 yearly salary for his services, as follows:

Return on separate capital—Separate income	$53,900
Salary—Community income	24,000
Total	77,900

Formula applied to allocate remaining ordinary income:

$$\text{Percent reported as separate} \frac{539}{779} = 69.2\%$$

$$\text{Percent reported as community} \frac{240}{779} = 30.8\%$$

In tax returns for prior years plaintiff used the same formula, and agreed to the use of the same percentage return and salary after his returns had been audited by revenue agents. The above percentages were used by the Commissioner of Internal Revenue in determining the deficiency for the year 1944 resulting from the fraudulent omission from income in the amount of $225,000.

6. In filing separate income tax returns for 1944, plaintiff reported his separate income and his half of the community income, allocated as shown above, and Birda Marie reported the remaining half of the community income. Plaintiff's tax return disclosed a tax liability of $137,565.15, which he paid on or about March 15, 1945. Thereafter, a deficiency was assessed against plaintiff for 1944 in the sum of $1,457.96, which, together with interest thereon in the sum of $125.60, was paid about January 31, 1947. On or about August 1, 1949, a further deficiency, resulting from the fraudulently concealed $225,000, allotted proportionally to plaintiff in accordance with the formula shown in finding 5, was assessed against plaintiff in the sum of $167,885.97, together with a fraud penalty in the sum of $84,671.97. This assessment of income taxes and penalties, together with interest in the sum of $50,774.14, was paid by plaintiff in January 1949 and May 1950. On August 12, 1949, Birda Marie was also assessed a deficiency on the resulting increase in her share of the community income. Payment was made on April 19 and May 2 of 1950.

7. On or about March 24, 1952, plaintiff filed a claim for refund based on the same grounds as stated in a subsequent suit for refund (set out in finding 8).

8. On May 3, 1954, plaintiff filed suit against the District Director of Internal Revenue at Los Angeles in the U.S. District Court for the Southern District of California, in which he made, in substance, the following statements:

(a) The total amount paid as income tax for the taxable year 1944, together with penalty and interest, was $442,480.80.

(b) His income tax liability for 1944 did not exceed $163,347.83, which sum, together with penalty and interest as provided by law, did not exceed an aggregate of $182,169.68, and that the amount in excess thereof was erroneously and illegally assessed against plaintiff.

(c) In the preparation of plaintiff's return for 1944 an allocation was made of his income between his separate income and the community income of plaintiff and Birda Marie.

(d) That allocation did not take into account the unique and extraordinary personal services plaintiff performed in the production of that income, and the allocation was, therefore, erroneous.

(e) In the preparation of his return the plaintiff's separate income was overstated and the community income was understated.

(f) To give due recognition to the unique and extraordinary services rendered by plainitff in 1944, the portion of his income properly allocable to separate property did not exceed $44,030.24, and the remainder of the ordinary income for 1944, in the sum of $132,-764.15, was the community income of plaintiff and Birda Marie.

9. Plaintiff's refund suit was tried before U.S. District Court Judge Jertberg, sitting in Fresno, California. Judge Jertberg entered an order for judgment on December 18, 1956 (*Karpe v. Riddell* (S.D. Cal.), 51 A.F.T.R. 1522). The court concluded that, in allocating income between plaintiff's separate income and the community income of plaintiff and his wife for 1944, a formula based on an 8 percent return on separate property and a yearly salary for plaintiff's services of $60,000 was reasonable, set out as follows:

Return on separte income—Separate income	$61,891.76
Salary—Community income	60,000.00
Total	121,891.76

Formula applied to allocate remaining ordinary income:

$$\text{Percent reportable as separate} \frac{6,189}{12,189} = 50.77\%$$

$$\text{Percent reportable as community} \frac{6,000}{12,189} = 49.23\%$$

10. Judge Jertberg further found as a fact:

XIII

$210,152.99 of the plaintiff's ordinary income for 1944 was separate property and $203,778.45 was community, of which $101,889.22 is taxable to the plaintiff's wife.

11. Judge Jertberg made the following conclusions of law:

I

This Court has jurisdiction of the subject matter and of the parties hereto under 28 U.S.C. Section 1340.

II

50.77% or $210,152.99 of the plaintiff's ordinary income for the year 1944 was separate income and 49.23% or $203,778.45, community.

III

The plaintiff fraudulently omitted income from grain sales from the net income reported on his 1944 federal income tax return and is entitled to a refund of fraud penalty only to the extent of fifty percent of the overpayment of tax determined herein.

IV

Plaintiff overpaid his 1944 federal income tax in the sum of $55,317.46, fraud penalty in the sum of $27,658.73, and interest in the sum of $14,378.74, a total of $97,354.93.

V

Plaintiff is entitled to judgment against the defendant for the year 1944 in the sum of $97,354.93, together with interest as allowed by law.

* * * * *

12. Judgment became final on February 18, 1957. On that date the statute of limitations for assessment and collection against Birda Marie for the year 1944 had run.

13. As a consequence of the determination made in the above-noted lawsuit reallocating plaintiff's income as between separate and community, Birda Marie's share of the community income was increased, which resulted in a deficiency in her income tax for the year 1944. On April 30, 1957, additional taxes and interest

in the amount of $55,868.05 were assessed against Birda Marie. That assessment was abated on May 24, 1957.

14. On August 2, 1957, Birda Marie was sent a statutory notice of deficiency. Attached to the notice was a statement, in part, as follows:

> The deficiency shown herein is asserted under the provisions of section 1314 of the Internal Revenue Code of 1954 and corresponding provisions of the Internal Revenue Code of 1939.

"Explanation of Adjustment," also attached to the notice, was as follows:

> (a) In a judgment rendered on December 18, 1956 by the United States District Court for the Southern District of California, Northern Division, in the case of A. H. Karpe vs. Robert A. Riddell, District Director of Internal Revenue, No. 1357-ND Civil, it was found that $203,778.45 of the total ordinary net income of A. H. Karpe for the taxable year ended December 31, 1944, represented community income.
>
> Therefore, the net income reported in your amended return, which was based on a report of examination dated October 14, 1946, is increased to include your share of the community income of $203,778.45 as determined by the District Court, or $101,889.22. Inasmuch as you reported $64,372.89, your income is increased in the amount of $37,516.33.

15. Birda Marie failed to file a petition in the Tax Court within 90 days after the notice of deficiency was mailed.

16. On or about May 8, 1957, the defendant issued plaintiff a notice of adjustment showing that plaintiff was due a refund of $83,081.70 consisting of an overpayment of $42,208.68 and interest of $40,873.02, and that an additional overpayment of $55,868.05 had been credited to the deficiency of Birda Marie on April 30, 1957. The amount of $83,081.70 was refunded to plaintiff.

17. The credit of $55,868.05 to Birda Marie, described above, was reserved on May 24, 1957, because the assessment against her in that amount made on April 30, 1957, was abated on May 24, 1957.

18. On or about December 6, 1957, defendant sent plaintiff a second notice of adjustment showing the sum of $55,868.05, plus interest thereon of $1,163.83, had been credited against the income tax liability assessed against Birda Marie on December 6, 1957, for the taxable year 1944.

19. It is plaintiff's contention that defendant erroneously assessed additional taxes against Birda Marie for 1944 in that the statute of limitations barred such assessment. Plaintiff also contends that defendant erroneously credited his overpayment for 1944 to Birda Marie's deficiency for 1944. He first contested defendant's action by suit filed March 28, 1958, in U.S. District Court for the Southern District of California. On September 10, 1958, the court dismissed that action for want of jurisdiction. Plaintiff filed notice of appeal which was dismissed on March 11, 1959.

20. On April 1, 1959, Birda Marie file a claim for refund for the year 1944 in the amount of $55,868.05. On April 8, 1959, plaintiff filed suit in this court. On

April 17, 1961, defendant filed a cross-claim against Birda Marie which was answered by her on July 10, 1961.

21. Plaintiff did not at any time enter into any agreement with the defendant or any agency thereof consenting to the crediting of any overassessment due him against any additional income tax or interest claimed by defendant to be due from cross-defendant Birda Marie for the year 1944. There is, however, a contract between plaintiff and cross-defendant, as set out in finding 23.

22. On or about May 22, 1956, plaintiff and cross-defendant Birda Marie entered into an agreement in writing which, since that time, has been and now is in full force and effect according to its terms.

23. The agreement referred to in finding 22, according to its terms, provides as follows:

(1) Plaintiff is required to pay any deficiencies in income tax or penalties or interest thereon assessed against plaintiff and cross-defendant or either of them for any year from the date of their marriage to and including the year 1955.

(2) Plaintiff shall have the right to protest or contest any such deficiency or deficiencies in income tax or penalties or interest assessed against plaintiff and cross-defendant or either of them, and cross-defendant is required to cooperate in said contest or protest by the execution of such protest or other documents, instruments, or papers prepared by plaintiff which may be reasonable, convenient, or necessary to contest and/or settle said protested assessments.

(3) Plaintiff can require cross-defendant to execute and deliver to plaintiff or his designee her power of attorney to do all things necessary, expedient, or proper in connection with any and all deficiency assessments in income taxes, penalties, or interest, including, but not limited to, the executing of such instruments as may be necessary, expedient, or proper in protesting and contesting assessments.

(4) Without limiting the generality of plaintiff's obligation to pay all deficiencies assessed against plaintiff and cross-defendant or either of them for any period during their marriage, and plaintiff's right to protest or contest any such deficiency, and cross-defendant's obligation to execute any such protest or other document in connection therewith prepared by plaintiff, and plaintiff's right to require cross-defendant to execute her power of attorney to him or his designee sufficient to permit execution of any and all documents necessary for protesting and contesting assessments, plaintiff must pay any income tax deficiency assessed against cross-defendant for the calendar year 1944 and hold her harmless on account thereof, and cross-defendant must cooperate fully with plaintiff and shall employ the attorney or attorneys selected by plaintiff, in the event plaintiff shall elect to contest any such proposed deficiency against cross-defendant by reason of the claim for refund made by plaintiff for the calendar year 1944.

(5) Any refunds of income taxes, penalties, or interest made to plaintiff and cross-defendant or either of them shall belong to plaintiff.

(6) Any refund due on account of overpayment of income taxes, penalties, or interest for the calendar year 1944 shall belong to plaintiff.

(7) Any service of notice of demand in writing by cross-defendant upon plaintiff made by mail shall be addressed to plaintiff in care of Lloyd G. Rainey and J. Everett Blum, 139 South Beverly Drive, Beverly Hills, California, or at such other address in Los Angeles County, California, as plaintiff may designate in writing served upon cross-defendant.

24. During the period from and including the month of February 1957 through the month of May 1959, Lloyd G. Rainey and J. Everett Blum, attorneys at law specializing in matters of taxation, were representing plaintiff as his attorneys and agents, and made the fact of such representation and agency known to cross-defendant during all of that period. During that period, Lloyd G. Rainey and J. Everett Blum knew that a deficiency would be assessed against cross-defendant for the year 1944.

25. The written agreement between plaintiff and cross-defendant made and entered into on or about May 22, 1956, was drafted by Lloyd G. Rainey and J. Everett Blum, acting as attorneys for plaintiff.

26. The written agreement between plaintiff and cross-defendant contains no provision stating that cross-defendant was at any time required to transmit or submit to plaintiff any documents in connection with any income tax deficiency assessment or claim for refund.

27. No act or omission of cross-defendant caused the denial of any substantive right to plaintiff, and no act or omission of cross-defendant caused the denial of any procedural right which was available to plaintiff.

28. No act or omission of cross-defendant has caused any damages to plaintiff measurable in money.

29. Neither plaintiff nor anyone in his behalf ever requested cross-defendant to execute any protest or other document, instrument, or paper in connection with any income tax deficiency proposed or assessed, or any power of attorney for executing instruments necessary, expedient, or proper in protesting or contesting any income tax assessments, prior to May of 1959.

30. Prior to May 14, 1957, plaintiff's attorney J. Everett Blum thought that a deficiency notice had been issued against cross-defendant for the year 1944, but did not request cross-defendant to file a protest or a petition in the Tax Court and did not request her power of attorney. The time for filing protest did not, in fact, expire until May 17, 1957, and the time for filing a petition in the Tax Court did not finally expire until November 1, 1957.

31. The proof is not deemed adequate to support a finding that cross-defendant failed or refused to comply with the terms of the property settlement agreement.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover, and the petition is therefore dismissed.

Statutes Involved.
26 U.S.C. 1311-1315.

SEC. 1311. CORRECTION OF ERROR.

(a) General Rule.—If a determination (as defined in section 1313) is described in one or more of the paragraphs of section 1312 and, on the date of the determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented by the operation of any law or rule of law, other than this part and other than section 7122 (relating to compromises), then the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in section 1314.

(b) Conditions Necessary for Adjustment.—

(1) Maintenance of an inconsistent position.—Except in cases described in paragraphs (3)(B) and (4) of section 1312, an adjustment shall be made under this part only if—

(A) in case the amount of the adjustment would be credited or refunded in the same manner as an overpayment under section 1314, there is adopted in the determination a position maintained by the Secretary or his delegate, or

(B) in case the amount of the adjustment would be assessed and collected in the same manner as a deficiency under section 1314, there is adopted in the determination a position maintained by the taxpayer with respect to whom the determination is made,

and the position maintained by the Secretary or his delegate in the case described in subparagraph (A) or maintained by the taxpayer in the case described in sub-

paragraph (B) is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be.

(2) Correction not barred at time of erroneous action.—

(A) Determination described in section 1312 (3)(B).—In the case of a determination described in section 1312(3)(B) (relating to certain exclusions from income), adjustment shall be made under this part only if assessment of a deficiency for the taxable year in which the item is includible or against the related taxpayer was not barred, by any law or rule of law, at the time the Secretary or his delegate first maintained, in a notice of deficiency sent pursuant to section 6212 or before the Tax Court of the United States, that the item described in section 1312(3)(B) should be included in the gross income of the taxpayer for the taxable year to which the determination relates.

(B) Determination described in section 1312 (4).—In the case of a determination described in section 1312(4) (relating to disallowance of certain deductions and credits), adjustment shall be made under this part only if credit or refund of the overpayment attributable to the deduction or credit described in such section which should have been allowed to the taxpayer or related taxpayer was not barred, by any law or rule of law, at the time the taxpayer first maintained before the Secretary or his delegate or before the Tax Court of the United States, in writing, that he

was entitled to such deduction or credit for the taxable year to which the determination relates.

(3) Existence of relationship.—In case the amount of the adjustment would be assessed and collected in the same manner as a deficiency (except for cases described in section 1312(3)(B)), the adjustment shall not be made with respect to a related taxpayer unless he stands in such relationship to the taxpayer at the time the latter first maintains the inconsistent position in a return, claim for refund, or petition (or amended petition) to the Tax Court of the United States for the taxable year with respect to which the determination is made, or if such position is not so maintained, then at the time of the determination.

SEC. 1312. CIRCUMSTANCES OF ADJUSTMENT.

The circumstances under which the adjustment provided in section 1311 is authorized are as follows:

(1) Double inclusion of an item of gross income.—The determination requires the inclusion in gross income of an item which was erroneously included in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer.

(2) Double allowance of a deduction or credit.—The determination allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year or to a related taxpayer.

(3) Double exclusion of an item of gross income.—

(A) Items included in income.—The determination requires the exclusion from gross income of an item included in a return filed by the taxpayer or with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another taxable year, or from the gross income of a related taxpayer; or

(B) Items not included in income.—The determination requires the exclusion from gross income of an item not included in a return filed by the taxpayer and with respect to which the tax was not paid but which is includible in the gross income of the taxpayer for another taxable year or in the gross income of a related taxpayer.

(4) Double disallowance of a deduction or credit.—The determination disallows a deduction or credit which should have been allowed to, but was not allowed to, the taxpayer for another taxable year, or to a related taxpayer.

(5) Correlative deductions and inclusions for trusts or estates and legatees, beneficiaries, or heirs.—The determination allows or disallows any of the additional deductions allowable in computing the taxable income of estates or trusts, or requires or denies any of the inclusions in the computation of taxable income of beneficiaries, heirs, or legatees, specified in subparts A to E, inclusive (secs. 641 and following, relating to estates, trusts, and beneficiaries) of part I of subchapter J of this chapter, or corresponding provisions of prior in-

ternal revenue laws, and the correlative inclusion or deduction, as the case may be, has been erroneously excluded, omitted, or included, or disallowed, omitted, or allowed, as the case may be, in respect of the related taxapayer.

(6) Correlative deductions and credits for certain related corporations. — The determination allows or disallows a deduction (including a credit) in computing the taxable income (or, as the case may be, net income, normal tax net income, or surtax net income) of a corporation, and a correlative deduction or credit has been erroneously allowed, omitted, or disallowed, as the case may be, in respect of a related taxpayer described in section 1313(c)(7).

Addition.—Sec. 1312(6) was added by Sec. 59(a) of Public Law 85-866, Sept. 2, 1958, (qualified effective date rule in Sec. 59(c) of Public Law 85-866, Sept. 2, 1958).

(7) Basis of property after erroneous treatment of a prior transaction.—

(A) General rule.—The determination determines the basis of property, and in respect of any transaction on which such basis depends, or in respect of any transaction which was erroneously treated as affecting such basis, there occurred, with respect to a taxpayer described in subparagraph (B) of this paragraph, any of the errors described in subparagraph (C) of this paragraph.

(B) Taxpayers with respect to whom the erroneous treatment occurred.—The taxpayer with

respect to whom the erroneous treatment occurred must be—

(i) the taxpayer with respect to whom the determination is made,

(ii) a taxpayer who acquired title to the property in the transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title, or

(iii) a taxpayer who had title to the property at the time of the transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title, if the basis of the property in the hands of the taxpayer with respect to whom the determination is made is determined under section 1015(a) (relating to the basis of property acquired by gift).

(C) Prior erroneous treatment.—With respect to a taxpayer described in subparagraph (B) of this paragraph—

(i) there was an erroneous inclusion in, or omission from, gross income,

(ii) there was an erroneous recognition, or nonrecognition, of gain or loss, or

(iii) there was an erroneous deduction of an item properly chargeable to capital account or an erroneous charge to capital account of an item properly deductible.

Last amendment.—Sec. 1312(7) appears above as renumbered by Sec. 59(a) of Public Law 85-866, Sept. 2, 1958, (qualified effective date rule in Sec. 59(c) of

Public Law 85-866, Sept. 2, 1958). Sec. 1312(7) as it read before this amendment is in P-H Cumulative Changes.

SEC. 1313. DEFINITIONS.

(a) Determination.—For purposes of this part, the term "determination" means—

(1) a decision by the Tax Court or a judgment decree, or other order by any court of competent jurisdiction, which has become final;

(2) a closing agreement made under section 7121;

(3) a final disposition by the Secretary or his delegate of a claim for refund. For purposes of this part, a claim for refund shall be deemed finally disposed of by the Secretary or his delegate—

(A) as to items with respect to which the claim was allowed, on the date of allowance of refund or credit or on the date of mailing notice of disallowance (by reason of offsetting items) of the claim for refund, and

(B) as to items with respect to which the claim was disallowed, in whole or in part, or as to items applied by the Secretary or his delegate in reduction of the refund or credit, on expiration of the time for instituting suit with respect thereto (unless suit is instituted before the expiration of such time); or

(4) under regulations prescribed by the Secretary or his delegate, an agreement for purposes of this part, signed by the Secretary or his delegate and by any person, relating to the liability of

such person (or the person for whom he acts) in respect of a tax under this subtitle for any taxable period.

(b) Taxpayer.—Notwithstanding section 7701(a)-(14), the term "taxpayer" means any person subject to a tax under the applicable revenue law.

(c) Related Taxpayer.—For purposes of this part, the term "related taxpayer" means a taxpayer who, with the taxpayer with respect to whom a determination is made, stood, in the taxable year with respect to which the erroneous inclusion, exclusion, omission, allowance, or disallowance was made, in one of the following relationships:

(1) husband and wife,

(2) grantor and fiduciary,

(3) grantor and beneficiary,

(4) fiduciary and beneficiary, legatee, or heir,

(5) decedent and decedent's estate,

(6) partner, or

(7) member of an affiliated group of corporations (as defined in section 1504).

SEC. 1314. AMOUNT AND METHOD OF ADJUSTMENT.

(a) Ascertainment of Amount of Adjustment.—In computing the amount of an adjustment under this part there shall first be ascertained the tax previously determined for the taxable year with respect to which the error was made. The amount of the tax previously determined shall be the excess of—

(1) the sum of—

(A) the amount shown as the tax by the taxpayer on his return (determined as provided in section 6211(b)(1) and (3), relating to the definition of deficiency), if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in section 6211(b)(2), made. There shall then be ascertained the increase or decrease in tax previously determined which results solely from the correct treatment of the item which was the subject of the error (with due regard given to the effect of the item in the computation of gross income, taxable income, and other matters under this subtitle). A similar computation shall be made for any other taxable year affected, or treated as affected, by a net operating loss deduction (as defined in section 172) or by a capital loss carryover (as defined in section 1212), determined with reference to the taxable year with respect to which the error was made. The amount so ascertained (together with any amounts wrongfully collected as additions to the tax or interest, as a result of such error) for each taxable year shall be the amount of the adjustment for that taxable year.

(b) Method of Adjustment.—The adjustment authorized in section 1311 (a) shall be made by assessing and collecting, or refunding or crediting, the amount thereof in the same manner as if it were a deficiency determined by the Secretary or his delegate with respect to the taxpayer as to whom the error was made or an

overpayment claimed by such taxpayer, as the case may be, for the taxable year or years with respect to which an amount is ascertained under subsection (a), and as if on the date of the determination one year remained before the expiration of the periods of limitation upon assesment or filing claim for refund for such taxable year or years. If, as a result of a determination described in section 1313(a)(4), an adjustment has been made by the assessment and collection of a deficiency or the refund or credit of an overpayment, and subsequently such determination is altered or revoked, the amount of the adjustment ascertained under subsection (a) of this section shall be determined on the basis of such alteration or revocation and any overpayment or deficiency resulting from such determination shall be refunded or credited, or assessed and collected, as the case may be, as an adjustment under this part. In the case of an adjustment resulting from an increase or decrease in a net operating loss which is carried back to the year of adjustment, interest shall not be collected or paid for any period prior to the close of the taxable year in which the net operating loss arises.

(c) Adjustment Unaffected by Other Items.—The amount to be assessed and collected in the same manner as a deficiency, or to be refunded or credited in the same manner as an overpayment, under this part, shall not be diminished by any credit or set-off based upon any item other than the one which was the subject of the adjustment. The amount of the adjustment under this part, if paid, shall not be recovered by a claim or suit for refund or suit for erroneous refund based upon any item other than the one which was the subject of the adjustment.

Last amendment.—Sec. 1314(c) appears above as amended by Sec. 59(b) of Public Law 85-866, Sept. 2, 1958 (qualified effective date rule in Sec. 59(c) of Public Law 85-866, Sept. 2, 1958). Sec. 1314(c) as it read before this amendment is in P-H Cumulative Changes.

(d) Periods for Which Adjustments May Be Made.—No adjustment shall be made under this part in respect of any taxable year beginning prior to January 1, 1932.

(e) Taxes Imposed by Subtitle C.—This part shall not apply to any tax imposed by subtitle C (sec. 3101 and following relating to employment taxes).

SEC. 1315. EFFECTIVE DATE.

(a) In General.—This part shall apply only to determinations (as defined in section 1313(a)) made after the 90th day after the date of enactment of this title.

(b) Transitional Provision.—Notwithstanding any other provision of this title, section 3801 of the Internal Revenue Code of 1939 shall apply to determinations (as defined in subsection (a) of such section) made on or before such 90th day as if this title had not been enacted.

26 U.S.C. 6501(a).

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

(a) General Rule.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

Last amendment.—Sec. 6501(a) appears above as amended by Sec. 165(a) of Public Law 85-859, Sept. 2, 1958, effective (Sec. 1(c) of Public Law 85-859, Sept. 2, 1958) Jan. 1, 1959. Sec. 6501(a) as it read before this amendment is in P-H Cumulative Changes.

In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 593

A. H. KARPE, PETITIONER

v.

THE UNITED STATES AND BIRDA M. VIERA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

During 1944, petitioner and his wife derived income from a business owned by petitioner. Under California law, the portion of the income attributable to the business assets was petitioner's separate property, while the portion attributable to his services was community property. In their separate income tax returns filed for that year, petitioner and his wife treated only 30.8% of the business income as community property, with the petitioner thus reporting 84.6% of the income and his wife reporting only 15.4%.[1] Petitioner later sued for refund, contending

[1] Deficiencies arising from omitted items of business income were later assessed and paid on the same basis.

that a larger part of the business income was community property and, hence, that a smaller part of it was taxable to him. Sustaining his contention in part, the district court determined that 49.2% of the business income was community property and, hence, that only 75.4% of it was taxable to petitioner, the remaining 24.6% being taxable to his wife. The judgment in that suit became final in February 1957. Six months later, the Commissioner determined a deficiency against petitioner's wife, increasing her income by the amount of the business income (11.2%) which was determined to have been erroneously included in petitioner's income. At that time, the normal period of limitations for the assertion of a deficiency against the wife had expired. The sole question is whether the notice of deficiency was timely under the provisions of the Internal Revenue Code (§§ 1311–1314) raising the bar of the statute of limitations in certain circumstances when an item of income has been treated inconsistently by related taxpayers.[2]

If related taxpayers report income on one basis and one of them later obtains a refund judgment premised upon the treatment of an item inconsistent with the way it was originally treated, the Commissioner is generally allowed one year from the date of the judgment within which to determine a compensating deficiency against the related taxpayer (§§ 1311–1314).

[2] The resulting assessment against his wife was deducted from the refund due petitioner because of his undertaking, in a divorce settlement agreement, to pay his wife's taxes, but no question is raised here as to petitioner's liability for the amount in issue if the assessment was not barred by limitations.

Petitioner and his wife were admittedly "related taxpayers" for that purpose (§ 1313(c)), and the notice of deficiency was admittedly timely if:

> The determination [made by the district court in 1957] require[d] the exclusion from gross income of an item included in a return filed by the taxpayer [petitioner] or with respect to which tax was paid and which was erroneously excluded or omitted * * * from the gross income of a related taxpayer [his wife]; * * * [§ 1312(3)(A)]

and if the district court, in its determination, "adopted * * * a position maintained by the taxpayer" in that proceeding (§ 1311(b)(1)(B)).

Petitioner contends[3] (1) that the portion of the business income which the district court in 1957 held had been erroneously included in his income and should have been included in his wife's was not an "item" of income within the meaning of § 1312(3)(A) (which he contends is limited to specific units of income separately entered on the return, such as a dividend on particular stock); and (2) that, since the district court allocated the business income between separate property and community property by a somewhat less favorable formula than that urged by petitioner, it did not "adopt" the "position" "maintained" by him within the meaning of § 1311(b)(1)(B). The arguments are frivolous on their face and were properly rejected by the Court of Claims. No

[3] At least he so contended in the court below. His petition here does not say what substantive questions he means to raise

conflict on the substantive questions is even claimed, and the asserted difference between the Court of Claims and other courts in applying a "liberal" rather than a "strict" rule of construction to the mitigation provisions is beside the point. Not only does the rejection of petitioner's insubstantial arguments not turn upon such intangible differences of approach, but such a difference would not in any event constitute a "conflict" of decisions of the sort required for review here.

Petitioner's final argument that the mitigation provisions were not properly pleaded or otherwise placed in issue was adequately and fully answered by the Court of Claims (Pet. App. 7–8). Not only is the Tax Court decision cited by petitioner (Pet. 14–18) not in point, but a conflict with the Tax Court is not a ground for review here.

The petition for certiorari should be denied.

Respectfully submitted.

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